

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Lisa Irvine on April 28, 2006

DATED: May 30, 2006

On April 28, 2006, Troy Dahlberg of the Audit Committee, interviewed Lisa Irvine. Ms. Irvine was represented at this interview by her lawyer, Jahan Raissi, of Shartsis Friese LLP, who participated via telephone. Also present were Rahul Khona and Samer Rezkalia of KPMG, and myself. The interview took place in a conference room on the 3rd floor of the City Administration Building in San Diego and lasted approximately two hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our conversation with Ms. Irvine, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Dahlberg explained to Ms. Irvine that the interview was being conducted on behalf of the Audit Committee. He stated that Willkie Farr & Gallagher represented the Audit Committee and not Ms. Irvine personally, and therefore no attorney-client privilege between the Audit Committee and Ms. Irvine applied to this interview. He asked that Ms. Irvine keep the information discussed in the interview confidential, and stated that the Audit Committee would not share her comments with other interviewees, until the Audit Committee's report was made public.

Background

Mr. Dahlberg began the interview by asking Ms. Irvine to describe her employment history. Ms. Irvine began working for the City in 1986 in the Financial Management Division, working on the budget. She left the City in 1997 and returned in 1999. Before she left, Ms. Irvine was working in an "internal consulting arm" of the City called the "Optimization and Effectiveness" program, the purpose of which was to help the City become more efficient. In this position, her title was "Program Manager," and she reported to Pat Frazier (Deputy City Manager). When Ms. Irvine returned to work for the City in 1999, she returned to the Optimization and Effectiveness program and was promoted to the position of Financial Management Director in January 2001. Mr. Dahlberg asked Ms. Irvine if she was in charge of putting together the City's budget, and she responded that she was. Ms. Irvine clarified that she did not work with the budget while she was with the Optimization and Effectiveness program, but did work with the budget when she became the Financial Management Director in 2001. In

January 2005, Ms. Irvine became the Deputy City Manager for financial functions, replacing Pat Frazier.

City Organization

Mr. Dahlberg asked Ms. Irvine who was in charge of finance for the City from 2001 until 2003. Ms. Irvine stated that Mary Vattimo was the Deputy Director of Financing Services, which was a section of the Finance Department. Ms. Irvine did not recall when Ms. Vattimo was promoted to City Treasurer. Pat Frazier was the Deputy City Manager over financial functions, and she oversaw all of the City's financial aspects except for auditing and accounting, which were handled by the City Auditor. Ms. Frazier reported to the City Manager, and everyone in Finance was beneath her. Ms. Irvine explained that Ms. Vattimo started in Financing Services and was involved in economic forecasting and creating and managing the City's debt. Ms. Vattimo reported directly to Ms. Frazier.

Ms. Irvine stated that when she was the Financial Management Director, she reported to Ms. Frazier, and was responsible for creating a balanced budget and monitoring the expenditures of the City's departments. Ms. Irvine was also responsible for obtaining mid-year financing for departments if necessary. When Ms. Vattimo became the City Treasurer, she was responsible for managing the City's debt, making continuing disclosures, entering into new financings, and dealing with banks and investments. Ms. Irvine also mentioned Pat Nunez, who was responsible for Emergency Medical Services contracts.

Mr. Dahlberg asked if Lakshmi Kommi (Financing Services Manager) reported directly to Ms. Vattimo, and Ms. Irvine stated that she did. Mr. Dahlberg asked if Ms. Vattimo handled debt for the enterprise funds, such as water and sewer. Ms. Irvine responded that at one point Ms. Vattimo handled this debt, but later roles changed and Ms. Irvine did not know how involved Ms. Vattimo remained in enterprise debt. Ms. Irvine stated that Dennis Kahlie (Utilities Finance Administrator) also worked in Financing Services, and would have reported to Ms. Vattimo. Mr. Dahlberg asked Ms. Irvine if Mr. Kahlie would have been involved with public offerings of debt. Ms. Irvine responded that before she became Deputy City Manager she would not have known the answer to that question, but has since learned that he would have been involved.

Mr. Dahlberg asked Ms. Irvine who in Finance dealt with pension issues. Ms. Irvine responded that pension issues would have been handled by the Auditor & Comptroller's Office because Terri Webster (Deputy City Auditor) had a seat on the Retirement Board. Ms. Irvine stated that "that's who we look[ed] to for guidance," and when Ms. Vattimo joined the Retirement Board, "we looked to her as well." Mr. Dahlberg asked if Lawrence Grissom (CERS Administrator) or Paul Barnett (Assistant CERS Administrator) interacted with anyone from Finance. Ms. Irvine responded that the Finance people would have looked to the Board members as well, since the pension system was complex and the Board members understood it in greater detail than anyone else.

Mr. Dahlberg asked Ms. Irvine to explain the structure of the Accounting Department from 2001 until 2003. Ms. Irvine stated that Ed Ryan (City Auditor & Comptroller) was "at the top" and Terri Webster was the Assistant Auditor & Comptroller. Beneath Mr. Ryan and Ms. Webster were Darlene Morrow-Truver and Holly Reed-Falk (Financial Operations

Managers, Auditor & Comptroller's Office). Ms. Irvine believed that Rudy Graciano (Financial Operations Manager, Auditor & Comptroller's Office) was also at this level and that there were probably a total of five or six people in this position. Ms. Irvine did not know if any of these individuals would have reported to Mr. Ryan or Ms. Webster, and stated that those at Mr. Graciano's level reported directly to the City Council.

Blue Ribbon Committee

Mr. Dahlberg asked Ms. Irvine if she was involved in providing information to the Blue Ribbon Committee (BRC) during its investigation. She responded that she met with Link Ward, a BRC member, who had called her wishing to speak about deferred maintenance. Ms. Irvine stated that she was not a personal friend of Mr. Ward, and did not meet with any other BRC members.

Ms. Irvine explained that the BRC Report contained many recommendations, and those dealing with the pension were "farmed out" to CERS. Mr. Dahlberg asked who made the decision to give these recommendations to CERS to address, and Ms. Irvine replied that she may have had discussions with the City Manager or Ms. Lexin about how to divide responsibility for responding to the BRC Report, but did not recall who made this decision. She did not recall the Rules Committee telling her who it wanted to respond to the various recommendations.

Ms. Irvine noted that it took awhile for CERS to respond to these recommendations, and believed this was because the Board was worried about its statements being discoverable in a lawsuit that was ongoing. She remembered that the Mayor had asked Bill Baber (Mayor's staff) to make sure that the BRC recommendations were addressed, but did not recall any Council members contacting her to ask about this delay. Ms. Irvine noted that reports were coming in regarding the other recommendations, and she felt that "there was a good faith effort to implement the recommendations of the BRC."

Mr. Dahlberg asked Ms. Irvine why the City did not address all of the BRC's recommendations itself instead of delegating this responsibility to the pension system. She responded that "the pension people were the experts," and the City did not have an actuary. Mr. Dahlberg asked if this reason was understood by the elected officials, and Ms. Irvine responded that she believed the relationship between the City and CERS was not clear to anyone and had been "very muddy for a long time." Ms. Irvine believed that the City could not demand that CERS respond to these recommendations because CERS was separate from the City. She stated that "not everyone might have understood that." Ms. Irvine then stated that, looking back, the City simply delegated this issue to the people with pension expertise. She stated that if the City were in charge of this issue it might have decided to reduce its contributions, but the CERS Board should have been able to provide a clear assessment of their fiduciary duties in this regard.

Mr. Dahlberg asked if CERS might have been more favorable to the unions because union representatives sat on the CERS Board, and Ms. Irvine replied that she did not think this was the case.

Mr. Dahlberg asked Ms. Irvine if the BRC Report caused any concern in the Finance Department about the City's financial status. Ms. Irvine stated that the Report concluded that there was a deferred maintenance backlog and reserves were lower than they

should have been. She noted that the City had always had budgetary challenges. Mr. Dahlberg asked if there was a concern about going public with bad information about the City, and Ms. Irvine replied that she did not think so, but that other departments might have viewed this issue differently.

Meet & Confer

Mr. Dahlberg asked Ms. Irvine to explain how the City determined the impact on its budget of the benefits it granted in the 2002 Meet & Confer process. Ms. Irvine stated that Meet & Confer negotiations took place when a union contract was about to expire and that the Labor Relations Department was in charge of negotiating on behalf of the City. Ms. Irvine stated that, for example, if the Police Officers Association wanted a 2% salary increase in the next fiscal year, the Labor Relations Office would have asked a member of the Financial Management team to run a scenario of the impact of this benefit on the City's budget. Ms. Irvine stated that Dean Roberts performed these projections for a number of years. She said that when the union contract was multi-year, budget impact projections would predict the effect on the budget over the term of the contract.

Ms. Irvine explained that these projections did not involve actuarial determinations; they involved only simple projections such as calculating percentages of payroll when the City picked up some of the employee contributions. Mr. Dahlberg asked if these projections would only cover the current year, and Ms. Irvine responded that they would, since this was budgetary analysis and not actuarial analysis. Ms. Irvine did not know who in the City performed actuarial analyses of the budget impact of labor compensation. At this point, Mr. Raissi asked if Mr. Dahlberg was discussing actuarial calculations, and noted that the labor contracts were for a finite period of time. Mr. Dahlberg responded that these contracts granted certain finite benefits but also granted retirement benefits in perpetuity. Mr. Raissi asked Ms. Irvine if anyone at the City performed budgetary projections that "went out forever," and she responded that no one had. She stated that Financial Management looked at current-year budget impacts and did not do ten- or fifteen-year projections.

Mr. Dahlberg explained that he was trying to determine what analysis was done in the City on the impact of the benefits granted in Meet & Confer. Ms. Irvine stated that Mr. Roberts only handled "pieces" of the analysis, and that CERS ran other analyses that her department was not capable of performing. Ms. Irvine was not aware of the City Manager ever retaining an actuary to perform actuarial assumptions of labor benefits, and thought that CERS might have handled this analysis. Mr. Dahlberg asked who would perform projections to determine the total cost to the City of an increase in health care costs, for example. Ms. Irvine had never heard of such analysis and did not believe it was performed. She had no recollection of hearing about ten- or twenty-year projections.

Ms. Irvine was shown a document containing handwritten notes and dated December 6, 2001 (Exhibit 1). A list of names appears in the right margin of this document, which includes "Lisa." Mr. Dahlberg read the sentence in the notes, "not the best year to approach [retirement] for benefits," and asked Ms. Irvine if this document refreshed her memory of this meeting. Ms. Irvine stated that the notes seem to reflect a budget meeting, but there would have been more "players" present at such a meeting. In budget terms, this was called a "peek"; the budget team looked forward to figure out what the current-year budget and projected

revenue would look like in a future year. Ms. Irvine suggested that it was possible that these notes reflected a “peek” meeting.

Mr. Dahlberg asked Ms. Irvine if those meetings involved discussions about the economic condition or investment returns of the pension fund, and she said no. Mr. Dahlberg asked if Ms. Webster knew by the time of this meeting that CERS’s investment returns were decreasing, and Ms. Irvine responded that she did not think that was discussed at the meeting reflected in Exhibit 1.

Mr. Dahlberg asked Ms. Irvine if, prior to MP-2, she attended any meetings in which the MP-1 trigger was discussed. Ms. Irvine responded that she did not recall any such meetings, but noted that this issue might have gone over her head since she did not know about MP-1 at that time. She explained that based on her current knowledge, she knew that the trigger was a City concern at that time, but she was unaware personally of this issue at that time. Ms. Irvine had no recollection of having any discussions or attending any meetings where the trigger was discussed, prior to MP-2. She stated that she attended “strategy” meetings during Meet & Confer, which were attended by Mr. Ryan, Ms. Webster, Ms. Vattimo, and others, but did not recall projections about the trigger. Ms. Irvine clarified that the trigger might have been mentioned in these meetings, but she would not have paid attention to this topic because others at the meeting knew this issue better than she did, and she relied on them for information.

Ms. Irvine explained that budget numbers came from the Auditor’s Office which told her the ARC (Annually Required Contribution) and payroll percentage that needed to be budgeted. She noted that the City had since changed this process and the budgeting process has been more involved with pension costs, but at that time she was unable to “take this on.” Ms. Irvine stated that there was no connection between the benefits and contribution structure developed in Meet & Confer and budgeting. She believed that the City was struggling financially for so long and was such a complex organization that compartmentalization was necessary. She described the City’s attitude as “trying to get by year to year.” Her perception was that Mayor Murphy did not want to hear bad news and the City “hid dirty laundry.” It was the City Manager’s job to manage staff on this issue, but there was a time period where the attitude was to try to fix problems and “not let them out.” Ms. Irvine stated that this attitude had since changed, as the City has tried to become more open and transparent.

MP-2

Mr. Dahlberg asked Ms. Irvine if she recalled anyone in Finance performing calculations to determine the budgetary impact of the benefits granted under MP-2. Ms. Irvine responded that she did not recall anyone performing this work, and stated that it was “outside of what [she] was involved in.” She stated that the Labor Relations Managers, Cathy Lexin and Daniel Kelley, would know who they asked for this analysis. Ms. Irvine stated that she would have been surprised if they went to Ms. Frazier because Ms. Vattimo and Ms. Webster better understood pension issues. Ms. Irvine believed that CERS performed its own projections because it had an actuary and the Financial Management Department did not have the capability to perform this analysis. Mr. Dahlberg asked if the City could have contracted this work out, and Ms. Irvine replied that it could have, but was not asked to.

Mr. Dahlberg asked if this procedure changed when the City hired Towers Perrin. Ms. Irvine stated that it did, and that the City hired Towers Perrin because it wanted an independent actuary to oversee and “double-check” the CERS actuary. She explained that there were “questions and rumblings” and the City was not comfortable with the actuarial analysis performed by the CERS actuary to calculate payouts and liabilities. Ms. Irvine did not know if the City had an outside actuary from 2004 to 2005.

Mr. Dahlberg asked if Ms. Irvine recalled whether the City’s benefits packages were brought to Finance to be vetted. She did not believe that this occurred, but noted that Mr. Roberts might have performed this work without her knowledge. Ms. Irvine did not acquire a better understanding of this process when she became Deputy City Manager because there were no Meet & Confer negotiations during her tenure while she held that position.

Budgetary Process

Mr. Dahlberg asked if Ms. Irvine was involved in a one-year budgetary process, or a five- or ten-year process. She responded that the City ran an annual budget process, but there was a year or two when it attempted a biannual budget. This approach was discarded because it was too difficult to predict next-year revenues. Ms. Irvine stated that the City did not perform long-term projections until right before Lamont Ewell left his position as City Manager. At that point, the City worked with financial advisors to develop a five-year plan. Ms. Irvine noted that the City Council could create a multi-year budget, but was prevented by the Charter from appropriating funds for future years. She did not know why the City did not perform five- or ten-year budget forecasts.

Ms. Irvine was shown a memorandum dated March 16, 2005, summarizing her interview with Vinson & Elkins on February 10, 2005 (Exhibit 2). Mr. Dahlberg directed her to the second paragraph on page 4, which discussed a complaint that one of Ms. Irvine’s staff members had brought to her attention. Ms. Irvine explained that Mr. Roberts told her that he had a problem with Ernie Anderson (former Financial Management Director) asking him to take certain action regarding the budget that he was uncomfortable with. Ms. Irvine recalled that the issue might have involved Mr. Anderson asking Mr. Roberts to shave “a little off salary to make the budget balanced.” Ms. Irvine recalled that this complaint arose before 2001, but did not know when. Mr. Dahlberg asked if employees had an opportunity to raise issues like this, or if they were told just to follow orders. Ms. Irvine stated that Jack McGrory (City Manager) had an open-door policy on Fridays where employees could walk in to discuss issues with him, but she did not think there was a formal ethics committee. Ms. Irvine believed that some people might be offended if an employee brought a concern about them to another person, but others would not be bothered by this approach. Ms. Irvine stated that employees took advantage of this open-door policy to discuss issues with Mr. McGrory. She did not know if the same was true when Mr. Uberuaga was the City Manager, but believed that when Mr. Ewell became City Manager he was accessible and people went to him with their concerns.

Mr. Dahlberg then directed Ms. Irvine to the third paragraph on page 6, which discussed allegations that Ms. Irvine had heard concerning Service Level Agreements (SLA’s). Ms. Irvine explained that SLAs were agreements regarding the transfer of money between funds or departments which contained the conditions and cost of services contracted for and a process for dispute resolution. Prior to the use of SLAs, funds were transferred between departments for

work that was performed by one department for another, but there was no documentation of these transfers. Ms. Irvine stated that some taxpayer associations had become interested in allegations that SLAs were being used to improperly move money between the general fund and other City funds. She stated that these allegations were surprising because SLAs had been around for many years.

Disclosure

Mr. Dahlberg asked Ms. Irvine how much interaction the Auditor & Comptroller's Office had with the Financial Management Department regarding CAFRs (Comprehensive Annual Financial Statements) or offering documents. Ms. Irvine responded that the Auditor & Comptroller's Office did not interact with the Financial Management Department on this issue. She stated that the Financial Management Department only handled the budget, while the CAFR contained actuarial information. The Auditor & Comptroller's Office would probably have wanted to verify with the Financial Management Department the appropriations that were made, but that would have been the extent of the interaction between the departments. Ms. Irvine thought that the Auditor & Comptroller's Office worked closely with the Financing Services Department, which handled the City's debt. She believed that Lakshmi Kommi and Elizabeth Kelly (Program Manager, Financing Services) had a good understanding of accounting issues.

Ms. Irvine stated that she had no involvement with the Ballpark offering, other than budgeting the debt service payments. A representative from the Financing Services Department told her the amounts to budget for revenue and debt service, but Ms. Irvine had no involvement with the bond issuances.

City's Interaction with Outside Auditors

Ms. Irvine was shown an email from Ms. Webster to her and others dated October 17, 2002, regarding the auditing of CERS's financial statements (Exhibit 3). Mr. Dahlberg asked Ms. Irvine if she was aware of concerns on the part of the City about CERS's outside auditors, Calderon Jaham and Osborn (CJO). Ms. Irvine responded that quality concerns regarding CJO did not come to her attention until the City discovered errors in its financial statements. Ms. Irvine responded that CERS had the option of hiring a different auditor if they were displeased with CJO. She explained that the City hired an outside auditor and different City agencies were able to participate in this deal to gain a better rate on the auditor's services. Mr. Dahlberg asked if the water and sewer financials were audited by the same auditor, and Ms. Irvine responded that they were.

Ms. Irvine stated that she was not involved in the City's decision not to go forward with the financial statements audited by CJO. Ms. Irvine vaguely recalled that when the Auditor & Comptroller's Office performed a review of the City's financial statements and found additional errors, it was uncomfortable with the audit. Ms. Irvine was not sure who was involved in this decision, but learned afterwards that Paul Webber (Disclosure Counsel) "had a big role." Ms. Irvine explained that she only became involved in this issue once the decision had been made to retain new auditors. Mr. Dahlberg asked if she was concerned that CERS had released their CAFR in 2003, which was audited by CJO. Ms. Irvine responded that this decision was the Retirement System's choice and the City could not dictate this decision. Mr. Dahlberg noted that

Mr. Ryan was the auditor for both the City and CERS, and asked why he would have allowed CERS to release information if he felt that CJO was not good enough to perform the City's audit. Ms. Irvine stated that she did not know if Mr. Ryan had the authority to make this decision on behalf of CERS, and did not recall having conversations on this topic.

Remediation

Mr. Dahlberg asked if there would have been a role during the Meet & Confer process for an independent actuary on the City's side to provide information to the Finance Department and City Manager. Ms. Irvine responded that this would have been extremely helpful, especially when dealing with complex terms and issues. An independent actuary would have helped the City validate and project costs over a longer period of time. Mr. Dahlberg asked if the CERS actuary might not have had the City's best interest at heart. Ms. Irvine responded that the CERS actuary worked for the retirement system, and the City needed an actuary that was dedicated to it alone. She believed that the City should always have a contracted actuary that it could call on for all kinds of analyses.

W.F.G.

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EXHIBIT 1

PF 21
12/6/01

- Red Light =
assume no new in 02

- Honeygl
- Lamont
Ed

- Corp Sponsorship
200,000 Veri
250,000 Pepsi

Terry
Bruce
Lisa

- Right of Way

- Retirement Fund -

not the best year to approach ret for increase
in benefits

EXHIBIT 2

FINAL

M E M O R A N D U M

March 16, 2005

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TO: Paul S. Maco
Richard C. Sauer
William E. Lawler

FROM: Benjamin S. Lippard

RE: *City of San Diego*; Interview of Lisa Irvine

This memorandum summarizes the interview of Lisa Irvine. This memorandum does not contain a verbatim or a near-verbatim transcription of this interview, but rather is a general summary of my thoughts and mental impressions regarding our discussions. Significantly, it is organized to summarize issues thematically, and does not reproduce the order in which the interview actually occurred. There was no stenographer present at this interview, and given the nature of summarizing this type of discussion after the fact, it does not attempt to describe every statement or exchange and it is possible that there are errors in this account. It also assumes familiarity with the facts of this case, and does not provide context or explanation of every factual reference.

This memorandum is subject to the attorney client and the attorney work product privileges, as it was prepared in connection with our providing legal advice to the City of San Diego (the "City") in connection with a potential SEC and U.S. Attorney investigation regarding some of the matters discussed in this memorandum.

General overview of interview. Paul Maco and I met with Ms. Irvine for approximately two hours in the morning of February 10, 2005. Also participating in the interview were Bill Haegele and Minny Wang of KPMG. Ms. Irvine was represented at this interview by her attorney, Jahan Raissi. At the beginning of this interview, Mr. Maco provided Ms. Irvine with the standard introduction from the interview template, and noted that KPMG was present at the interview in connection with their ongoing audit of the City's financial statements. Ms. Irvine had no questions at this point. Ms. Irvine also stated that she was present at the interview voluntarily. The interview then followed the interview template.

Background. Ms. Irvine was hired by the City in 1986 as a Budget Trainee in the Financial Management Department. She worked there for a few years and moved up through the ranks at the City, where she has worked for 16 years. In about 1994 or 1995, Ms. Irvine left the City to work at KPMG as a manager in its state and local consulting group, where she spent 18

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months. In about 1997 or 1998, Ms. Irvine returned to the City, where she has increased in responsibility over time. From January 2001 to 2004, Ms. Irvine served as the Financial Management Director. Before that, she was the Optimization/Organizational Effectiveness Program Manager. Her current position is Deputy City Manager for Finance, and she reports to Lamont Ewell. Reporting to her are the Financial Management director, the Acting City Treasurer, and the Risk Manager. Ms. Irvine's predecessor was Ernie Anderson, who served in that position for approximately 10 years.

Role in financial reporting and disclosure. Ms. Irvine has very little involvement in financial reporting, only related to information involving the budget. She or her team may be asked to review economic indicators and budget information. In her time as Financial Management Director, she had very little involvement in this area, limited to the review of budget information.

The same is true for City disclosures. As Financial Management Director, she had very little involvement in disclosures, limited to the context of budget and revenue forecasting. Typically, the Financing Services Division contact would contact Lisa Irvine or someone in her department and provide them a write-up for comments and edits. There is a small piece of Appendix A that relates to the budget, and this is the only part of the disclosure documents that her department would review. The financing services contact was typically Lakshmi Kommi; while there could have been others, including perhaps Michael Carrier, Ms. Irvine did not remember them. After Ms. Irvine's department provided mark-up on this section of Appendix A, that was the end of their involvement and Ms. Irvine was not sure what the subsequent process was. Her department was not asked to review later versions.

Environment/tone of reporting. Ms. Irvine asked what time frame our questions in this area related to, and was told that it went from February 2004 back to January 1996. Ms. Irvine explained that she took over as Financial Management Director in 2001, and did not have much involvement in financial statements or disclosure documents, so she did not have an understanding of the general environment or tone from management regarding these issues. As the years went by, she gained a greater understanding of these areas, but is not close enough to these issues to have any view on what the tone was.

For the information her department provided in this context, the expectation was for high integrity and for high-quality, accurate numbers, with a clear articulation of which numbers were actual and which were projections. Ms. Irvine stated that those expectations were communicated by Pat Frazier, who had high expectations and wanted high quality work. In all of the documents she was involved with, Ms. Irvine spent time and effort to ensure their quality. These efforts were due to her own high standards, which she fostered among her staff. These high standards were also shared by Pat Frazier and the City Manager's Office.

Quality of City's financial reporting and disclosure practices. Ms. Irvine did not express a particular view on these issues. She noted that she was now aware of the issues

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identified in the V&E Report, and the City has made changes to ensure accuracy and responsibility. Prior to the V&E Report, she had some understanding of these shortcomings, as a result of learning of the financial statement errors approximately a month or two before the filing of the Voluntary Disclosure in January 2004. She herself was not involved in the preparation of that disclosure.

Intentional errors in financial statements and disclosure. Ms. Irvine did not believe that any errors in the financial statements were intentional.

Pressure to make inaccurate disclosure. Ms. Irvine stated that she had never been pressured to record accounting transactions incorrectly or to fail to disclose information she thought was material. Nor has she pressured any of her staff to do so. In response to a question from Mr. Haegele, Ms. Irvine stated that she did not recall conversations where the extent of disclosures was debated or where people showed a desire not to disclose things.

Changes in procedures. Ms. Irvine stated that she implemented changes in procedures when she became the Financial Management Director. She did not recall all of them, but she noted that there were procedures to increase the quality control for the budget documents, such as providing for multiple reviews of sections of documents, focusing on accuracy and readability, and comprehensive quality control reviews. Ms. Irvine explained that the procedures were designed to allow the budget to be planned realistically and accurately. It is sometimes hard to work with the City departments to determine what they really need, so communications procedures have been improved. The budget documents have also been automated, which has increased accuracy and improved the quality of life for budget staff due to decreased overtime. These changes were instituted because Ms. Irvine is conscientious and does not like making errors, and to improve the quality of the budget process.

Ms. Irvine stated that she was aware of changes in budget assumptions made by her predecessor to generate a balanced budget. She stated that in the budget system, departments budget by average employee salary multiplied by the number of positions. Some of her budget team members informed her that some departments did not get 100% of this amount in the past, in order to balance the budget. Ms. Irvine explained that there is some logic to this, as worker attrition means that departments have lower than budgeted expenditures and thus have some savings at the end of the year, and she noted that some cities only budget 95% due to these considerations. Ms. Irvine stated that she was not aware of other budgeting techniques like this at the City of San Diego. She also stated that even in those years where departments did not receive their full allocation, there was still money left over at the end of the year. These changes should not have any effect on the pension contributions, which are based on actual payroll, not budget. She also noted that in FY 05, due to the *Gleason* settlement, \$130 million has been budgeted as a lump sum to be contributed to Retirement from the City's funds.

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Ms. Irvine stated that the budget process begins in October and that her department must get a balanced budget to the Mayor and City Council by May for the fiscal year that begins the following July.

Ms. Irvine stated that in November, 2004, one of her staff members came to her and raised some concerns regarding the budgeting practices of her predecessors after he had raised the concerns in an interview with V&E attorneys. Ms. Irvine noted that he said he had been pressured in the past by her predecessor on these issues (although not by the V&E attorneys), and that she had encouraged him to raise his concerns, and he shared them with Lamont Ewell, the City Manager. Ms. Irvine's predecessor was one of the individuals terminated by Mr. Ewell when he became City Manager in April of 2004. Before this, the only notable complaints Ms. Irvine had received related to overtime, because her employees had to work hard as part of the budget process. To Ms. Irvine's recollection, there had never been any complaints regarding the integrity and quality of the budget process (prior to November 2004).

Interaction between budget and position issues. In response to a question from Mr. Haegele regarding the interaction between the budget process and the pension system, Ms. Irvine explained that the budget process is a plan based on an estimated number of employees and services, and that her department works with the City Auditor's office to get pension-related information. The budget department is not directly involved with the pension. For the budget process, they would ask the City Auditor to provide contribution rates based on the actuarial reports, with a percentage to be applied to particular salaries; the contribution rates are applied to average salaries to project budget amounts.

Ms. Irvine also explained that the budget is an annual process, and multi-year budgets are not prepared by her department, although the Capital Improvement Program has plans for 11 years of capital projects, and some City departments prepare their own projections for five-year periods. Ms. Irvine also stated that she thought that the unfunded pension liability could potentially end up in the contribution rate, but that this is calculated by the actuary, who calculates the required contribution rates for each year and provides his report to the City Auditor's Office. Ms. Irvine stated that there had been some pension underfunding, but she was not sure how the City Auditor married the MP I and II rates to the actuary reports, nor is the way the City Auditor calculates these rates visible to her department.

In response to another question from Mr. Haegele, Ms. Irvine stated that based on what she had read recently, the MP I trigger would have increased the money going to the retirement system.

Attempts to make City look good. Ms. Irvine was aware of no such efforts and stated that the first time she had heard about this was when she learned of Phil Phillips's quote.

CAFR – intentional errors or omissions. Ms. Irvine was not aware of any conscious efforts by individuals to intentionally omit material information or intentionally disclose erroneous information in the financial statements.

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Accounting entries – intentional errors or omissions. Ms. Irvine was not aware of any accounting entries that had intentionally been incorrect or intentionally omitted material information.

Disclosure documents – intentional errors or omissions. Ms. Irvine was not aware of any disclosure documents that had intentionally been incorrect or intentionally omitted material information.

Intentional misleading of particular groups. Ms. Irvine stated that she was not aware of any efforts by anyone at the City to mislead outside counsel, the outside auditing firm, the outside rating agencies, the City Council, the City Manager, or the SDCERS Board.

Auditor issues. As noted above, Ms. Irvine was not aware of any pressure from anyone to record transactions incorrectly, to not make material disclosures, to make the City look good, or to intentionally omit or misstate information in the CAFR.

Knowledge of illegal acts. Ms. Irvine was asked if she had any knowledge of “illegal acts” by City employees, and was instructed to interpret this term broadly. Mr. Rassi asked if this related to any illegal acts at all, including such things as employees stealing pencils. Mr. Maco clarified that the question is intended in the broadest possible way. Ms. Irvine stated that she was aware of no such illegal acts, except that she has some knowledge of illegal acts, as they come up in personnel matters involving individual employees. Ms. Irvine stated that these acts did not involve financial reporting or disclosure. Ms. Irvine stated that she was never instructed by anyone to commit illegal acts regarding financial reporting or disclosure, nor did she ever instruct any of her staff to perform such illegal acts. She was not aware of anyone else making such an instruction either.

Pension accounting. Ms. Irvine stated that she had no role in pension accounting or disclosure. Ms. Irvine was not aware of any efforts by anyone to mislead the pension board or its staff.

Role of outside auditors. Ms. Irvine stated that she was involved in the procurement process for CJO and was the contract administrator for C&L after they acquired CJO. After the procurement process, Ms. Irvine became aware that Doug McCalla (phonetic) of the Retirement staff was unhappy with them and wanted another auditor. This occurred around 2002, but Ms. Irvine was not aware of the exact time period. Ms. Irvine explained that the independent City agencies, including retirement, usually partner with the City on the annual audits.

Ms. Irvine stated that she did not recall specifically what the issues with CJO were, and that she did not recall Mr. McCalla providing specific details to her. Nor was she sure if Mr. McCalla was adamant on this point, or if Retirement ultimately went ahead with CJO. Last year, however, CERS hired an independent auditor different from the one used by the City. Ms. Irvine stated that she did not hear concerns from anyone but Mr. McCalla before the Voluntary Disclosure process began in late 2003. Ms. Irvine stated that she did not recall who

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she learned of the financial statement errors from, but it may have been Pat Frazier. Ms. Irvine learned that there may have been errors in the 2002 footnotes, and she was interested in this topic because she needed to know if she needed to take any action as contract administrator, such as whether C&L would be kept or if the City would need to find new auditors. Ms. Irvine thought that she heard of this in late Fall of 2003, but could not say for sure.

Shipione allegations. Due to Ms. Irvine's limited involvement in pension issues, she was not read all of the 41 allegations, but was asked more targeted questions on areas she had involvement in.

Ms. Irvine stated that she was familiar with Service Level Agreements, or SLAs, which are agreements between the General Fund and other City funds/departments regarding the money to be paid into the General Fund for services provided by General Fund employees. These SLAs enter the budget process. Ms. Irvine stated that she was aware of allegations regarding the SLA process being used to move unearned money into the General Fund, but was aware of no facts supporting these allegations. Ms. Irvine stated that the SLA process was formalized for exactly this reason – to ensure that other City funds/departments get the services they pay for – and she noted that many other cities do not have this level of formal procedures regulating such transfers.

Ms. Irvine was also aware of charges made by the Taxpayers Association regarding right-of-way issues, although she was not sure if they allege that the right of way charges are actually illegal. According to Ms. Irvine, there is extensive case law from other cities governing such charges, and the City has been working to ensure it is within the law on the right of way issue. She stated that she would continue to look to the City Attorney for advice on this issue. She was not aware of any facts supporting the claim that the City Attorney and the City are not following the case law on this issue.

Specific documents. The remainder of the interview primarily focused on specific documents (copies of the documents are attached for reference):

- *1/19/01 email from Terri Webster to Lisa Irvine (Tab 1).* Ms. Irvine had reviewed this document with her counsel in preparation for the interview, but otherwise did not recall it. She explained that from the face of the document, it appears to her as if the email involved a request for additional dollars allocated in the budget related to the offset discount, the portion of the employee contribution that the City pays for employees, which is budgeted and linked to the payroll system. Part of the offset is paid out of a retirement fund reserve, and the rest of the offset is paid by the City. Ms. Irvine was not aware of questions regarding the legality of this use of the reserve. She also explained that "PEEK" is a budgetary tool used to make sure that they have all the information they need for the budget.
- *3/8/02 Draft Report from the City Manager to the Mayor and Council re; Right-of-Way Transfer Charges. (Tab 2).* Ms. Irvine stated that she was familiar with this document, and that it recommends that a certain amount of the right of way charges be preserved.

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At this time, the City Council has directed the Manager to eliminate these charges, and at this point in time the charges had almost been reduced to zero. This report, however, argues that some of the right-of-way charges should be kept and that the Enterprise Funds should pay some charges for their use of the streets, like other utilities do. Ms. Irvine stated that she had consulted with the City Attorney on these issues, but was not sure with whom. It may have been Kelly Salt, a Deputy City Attorney, who helped out on right-of-way issues. It may also have been Stu Swett. There is case law on this topic from other areas of the state, so she was working with the City Attorney on the issue.

Ms. Irvine stated that she believes that this report was ultimately completed and provided to the Mayor and Council, and that the Council has supported \$2.3 million in right of way charges in the budget, which will be phased out in FY 2006. She agreed to try to find the final version for us. She also explained that "AYM" was Angela Means (phonetic), who helped write this report on Ms. Irvine's behalf. Ms. Irvine participated in the drafting, as well, but was not sure whose edits were reflected on this blackline version. Ms. Irvine's attorney later informed us that Ms. Irvine determined that the memo had not been finalized.

- *3/13/02 email from Martin Kane to Donna Goldsmith et al. (Tab 3).* Ms. Irvine had reviewed this document with her counsel in preparation for the interview, but otherwise did not recall it. She explained that all of the individuals copied on this email are part of her staff. After reviewing the document, she recalled that they were trying to find out how to gather street maintenance information so that people could see all the money being spent without having to search through separate parts of the budget. Ms. Irvine believes that they created a fund for streets, to show the transfers into and out of the fund, to make the process more transparent and not misleading.
- *3/13/02 email from Richard Mendes to Lisa Irvine et al. (Tab 4).* Ms. Irvine stated that this email appears as if she had asked Mr. Mendes for a chart. She stated that Mr. Mendes's concerns were taken into account and that any false impressions were avoided. Ms. Irvine was not sure why she had asked to "keep it out of the Revenue and Expense Statement," but because Streets was still in Transportation at the time, this information may not have been transparent. In 2004, Streets had its own revenue and expense statements. The overall intent was to make it clear how much the water and sewer funds were contributing to streets.
- *10/17/02 email from Terri Webster to Lisa Irvine et al. re: Outside Auditor (Tab 5).* Ms. Irvine stated that this document was familiar to her; it is an email that she sent to Cathy Lexin, Mary Vattimo, and Terri Webster regarding Mr. McCalla's concerns regarding CJO. Ms. Irvine did not recall what the specific mistakes referenced in this email were, and she was not sure if Mr. McCalla ever shared them with her. Ms. Irvine recalled that Mr. McCalla wanted a separate, independent auditor for CERS, and she thinks that she heard about this from the City Auditor's office. Ms. Irvine did not know

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why the Retirement System wanted to have its own auditor, since all of the other independent agencies wanted to participate with the City, but if CERS wanted to have a separate auditor, that was its prerogative. Ms. Irvine stated that there would be no additional cost to the City if CERS did this.

- *1/30/03 email from Lawrence Grissom to Loraine Chapin et al. re: Blue Ribbon Report (Tab 6).* Ms. Irvine was familiar with this document, and stated that Terri Webster had asked Lori Chapin questions regarding the Retirement presentation to the Blue Ribbon Committee. Ms. Irvine stated that she believed she was copied on this email because she was coordinating the City's responses to the Blue Ribbon Committee report to the City Council. Ms. Irvine was assigned the responsibility to track the recommendations and the responses, but this was primarily an administrative function. The Blue Ribbon Committee had made a list of recommendations, and Ms. Irvine was responsible for tracking who was responsible for responding to them. For some recommendations, like the general reserves, Ms. Irvine was involved in the substantive response. She worked with Bill Baber (phonetic) on this issue.

Ms. Irvine did not remember how she had been assigned this task, but thought it was probably by Mike Uberagua, the City Manager. Ms. Irvine maintained her files related to this project, but she had not been asked to produce these documents. She agreed to provide us with a copy of her file. (This was done by her counsel by letter dated February 18, 2005, which is attached.) Ms. Irvine did not recall any reports as part of this process that related to the granting of benefits or the Meet and Confer more generally.

Ms. Irvine did not have any understanding at the time regarding whether it was "against the rules" to pay health benefits out of earnings, but her understanding today is that in order to maintain CERS's tax status, money for retiree health care benefits must come directly from the employer. As of today, the pension system is in compliance with that requirement, the City is paying the benefit directly, and the reserve is exhausted.

- *12/30/03 email from John Kern to Les Girard et al. re: Retirement (Tab 7).* Ms. Irvine stated that she was familiar with this document, and that John Kern was expressing his frustration with the Union Tribune remarks that were outlandish. Ms. Irvine believes that she was an addressee on this email because Mr. Kern incorrectly assumed that because her title is Financial Management Director, she has something to do with Retirement, which is not correct. She does not recall taking any action in response to this email.
- *1/5/04 email from Rick Roeder to Terri Webster et al. re: FY 05 CERS numbers (Tab 8).* Ms. Irvine stated that she recognized the bottom part of this email, but not the top part, which she was not copied on. She does not recall whether the information contained in the top part of the email ever became known to her, nor does she know the outcome of the issues regarding the Enterprise Funds. She stated that the City wanted to pay as much as they could to the pension, and that the Enterprise Funds were to pay the full ARC

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because they have the ability to pay. If these funds did this, the City wanted to make sure that they were given full credit and were not subsidizing the General Fund. Ms. Irvine stated that she was copied on this email because she was working with the City departments to budget correctly for the full actuarial payment.

- *12/31/03 email from Bruce Herring to Lawrence Grissom et al. re: The DROP facts. (Tab 9).* Ms. Irvine stated that she was familiar with this email and that there was a series of emails regarding the DROP program, which related to the earlier email sent by John Kern. The Union Tribune reporters were putting out information that was not factual. Ms. Irvine was not sure why she was included on this email, perhaps because of the earlier John Kern email, or perhaps because as the Financial Management Director her team could pull together DROP-related information. The reference to the City being gagged relates to the *Gleason* lawsuit, because the City Attorney's Office had instructed the City staff not to discuss such issues in the press.

Ms. Irvine did not know if the examples provided in the email were accurate and does not recall having a view on that at the time. About one or two months ago, her department prepared a report on DROP to the Mayor and Council explaining the estimated DROP savings for FY 05, and that over the life of the program the savings is even larger. This report, however, only addressed the City's budget impact, not the retirement side, which would need to be looked at by the actuary, but it concluded that the DROP program saves \$15-16 million per year on the City's side. Her calculations included the City's obligation to make payments to the retirement system into the DROP reserve accounts, but Mr. Roeder would need to look at some issues, although Ms. Irvine was not sure precisely what those issues would be. Thus, her recent report is subject to adjustment based on Mr. Roeder's conclusions. Ms. Irvine was not sure if DROP will be kept or not, although there are some proposals to eliminate it, which she thought might cost the City more money.

- *2/13/04 email from Convis Whistleblower to Michael Uberagua et al. re: ConVis "Audit" (Tab 10).* Ms. Irvine was familiar with this email, which was an anonymous communication from a Convis employee. The City contributes TOT funds to Convis to promote conventions and visitors. Ms. Irvine explained that Financial Management staff were looking at Convis as part of their work as the contract administrator. She did not know what the writer meant by "real audit," but stated that the City Audit Division went to Convis and performed an audit. The report said that Convis is generally in compliance, but that the City needs to strengthen requirements to control how the funds are spent (e.g., no City funds spent on alcohol). These recommendations have been or will be carried out. Ms. Irvine stated that she does not receive such whistleblower communications frequently, although she has received Diann Shipione e-mails forwarded to her by other City employees. She stated she is not aware of any formal City procedures for addressing whistleblower complaints.

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Wrap-up questions. Ms. Irvine was not aware of any illegal conduct regarding financial reporting, accounting, pension benefits, health care benefits, disclosure or any other area, and she agreed to notify us if she later recalled anything related to any of the topics we had discussed in the interview.

Mr. Haegele had a number of additional questions for Ms. Irvine. In response, she stated that she had not been assigned any special projects related to the pension system, nor does she recall any analysis of the MP I trigger. She stated that Dean Roberts and his staff might have been involved in the Meet and Confer. Ms. Irvine also stated that her only interaction with the department of the Blue Ribbon Committee report was when she discussed deferred maintenance issues with Linc Ward. She did not recall any discussions regarding the accuracy of the Blue Ribbon Report, nor was she aware of any inaccuracy in it at the time it was developed.

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EXHIBIT 3

Close

PREVIOUS NEXT

From: Terri Webster
To: Irvine, Lisa; Vattimo, Mary; Lexin, Cathy
CC: Frazier, Patricia; Ryan, Ed
Date: 10/17/2002 1:13 PM
Subject: Re: Outside Auditor

Yes.. the City is required per Generally Accepted Accounting Principles to include the CERS Trust Fund in the City's Financial Statement and if the City's Auditor did not audit CERS it would result in a modified audit opinion versus the clean opinion we receive. The City does not want a modified audit opinion for its financial statements.

Terri

>>> Mary Vattimo 10/17/02 12:31PM >>>

can someone just confirm that regardless of whether the board decides to hire an auditor, the selected outside auditor that the city retains will still audit retirement financials.

thanks

>>> Lisa Irvine 10/17/02 12:11PM >>>

Cathy, Mary and Terri,

As a follow up regarding whether the Retirement office will be using another outside auditor, I wanted to share with you the conversation I had with Doug McCalla this morning.

I discussed with Doug the fact that Retirement was not included in the RFP process for the outside auditor. I apologized for our oversight and explained to Doug that we are in the process of drafting the agreement with the recommended firm and can still accommodate their needs within the agreement. He explained that due to the fiduciary responsibility of the Board, that they may want to hire an independent auditor (which of course I then explained that that is just what we were in the process of doing). He says that the current auditor, CJO, has not been responsive to their requests and has not been current on key pension issues. He also explained that CJO has made some mistakes that they have had to point out.

I explained that I was surprised with his comments since the other agencies which are also independent from the City have received very good services from CJO.

He explained that whether they use another outside auditor or use the City's outside auditor is a policy call that the Board will be making on Friday. He is recommending to the Board that they pursue their own outside auditor.

I look forward to hearing what the Board decides on this subject.

Lisa

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